

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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BRADLEY C. SMITH, derivatively on behalf of
OPPENHEIMER QUEST FOR VALUE FUNDS,

Plaintiff,

v.

OPPENHEIMERFUNDS DISTRIBUTOR, INC.,
MATTHEW P. FINK,
PHILLIP A. GRIFFITHS,
MARY F. MILLER,
JOEL W. MOTLEY,
MARY ANN TYNAN,
JOSEPH M. WIKLER,
PETER I. WOLD,
BRIAN F. WRUBLE,
DAVID K. DOWNES,
RUSSELL S. REYNOLDS, JR.,
WILLIAM F. GLAVIN,
THOMAS W. COURTNEY,
LACY B. HERRMANN, and
JOHN V. MURPHY,

Defendants,

OPPENHEIMER QUEST FOR VALUE FUNDS,

Nominal Defendant.
----- X

10 Civ. 7387 (LBS)

ECF Case

Electronically Filed

NOTICE OF SUPPLEMENTAL AUTHORITY

Defendants OppenheimerFunds Distributor, Inc. ("OFDI"), William F. Glavin, and John

V. Murphy respectfully request that the Court consider the October 22, 2010 decision in *Smith v.*

Franklin/Templeton Distributors, Inc., et al., No. 4:09-cv-04775-PJH (N.D. Cal), Dkt. No. 54

(copy attached as Exh. A hereto), as supplemental authority in support of their motion to dismiss the Complaint for failure to state a claim upon which relief can be granted.

By way of brief procedural background, this action and the substantively-identical *Gold* action were transferred to this Court from the District of Colorado, pursuant to 28 U.S.C. Sec. 1404(a), by Order dated September 23, 2010. *See* Dkt. No. 49. Prior to transfer, Defendants had filed motions to dismiss both Complaints for failure to state a claim (in addition to other grounds); the briefing on the motions was completed prior to transfer. *See* Dkt. Nos. 29, 41-42, 44.

As set forth in Defendants' motion to dismiss papers, the theory of Plaintiff's Complaints is that a mutual fund's general distributor and the fund's board of trustees necessarily violate both SEC Rule 38a-1 and Section 36(a) of the Investment Company Act of 1940 (the "ICA") by paying certain asset-based compensation related to the distribution of mutual fund shares, known generally as "Rule 12b-1 fees," to any broker-dealers that have not registered as investment advisers under the Investment Advisers Act of 1940 (the "IAA"). According to Plaintiff, this violation gives rise to a federal claim for "contract voiding" under Section 47(b) of the ICA, as well as assorted state common law claims for monetary relief. Pursuant to his federal claim, Plaintiff is seeking to void any agreement pursuant to which the Oppenheimer Quest for Value Funds and/or OFDI pay Rule 12b-1 fees to broker-dealers that are not registered as investment advisers.

As further set forth in Defendants' motions to dismiss, Plaintiff here, represented by the same outside counsel (Milberg LLP), commenced an almost identical derivative action on behalf

of Franklin Custodian Funds against Franklin/Templeton Distributors, Inc. and trustees of the mutual fund, asserting the same causes of action that he asserts here based upon factual assertions that are virtually indistinguishable from those contained in the Complaints now before this Court: *Smith v. Franklin/Templeton Distributors, Inc., et al.*, No. 4:09-cv-04775-PJH (N.D.Cal.). *See Quest* Mot. at 16-17 (Dkt. No. 29). On June 8, 2010, the district court judge in that action, the Honorable Phyllis Hamilton, granted defendants' motion to dismiss for many of the same reasons advanced by Defendants' pending motions here. Specifically, the *Franklin/Templeton* Court held that (i) Section 47(b) provides a remedy only where a plaintiff has properly alleged a violation of some other section of the ICA which itself provides for a private right of action, and (ii) Plaintiff had failed to allege a predicate violation of the ICA because, *inter alia*, neither ICA Section 36(a) nor SEC Rule 38a-1 provides a private right of action or requires a mutual fund, its trustees, or its general distributor to ensure that broker-dealers comply with their IAA registration requirements. *See id.*

Plaintiff thereafter filed an amended complaint in that action, re-asserting his Section 47(b) claim, in an attempt to remedy the defects identified by the Court. *See Smith v. Franklin/Templeton Distributors, Inc., et al.*, No. 4:09-cv-04775-PJH at Dkt. No. 45. On October 22, 2010, the Court found that this attempt fell far short and granted defendants' motion to dismiss Plaintiff's amended complaint with prejudice. In particular, Judge Hamilton reaffirmed that the theory advanced there – the same asserted here – did not plead a violation of ICA Section 47(b) because, *inter alia*, neither Section 36(a) nor Rule 38a-1 provides either an express or implied private right of action pursuant to which Plaintiff could even allege a violation

of Section 47(b). *See* Exh. A. hereto at pp. 3-5. The Court also concluded that Section 36(a) does not “create a federal fiduciary duty or regulate the improper use of Trust assets” and that Rule 38a-1 does not require a fund, its trustees, or its general distributor to ensure that unaffiliated broker-dealers are in compliance with their own IAA registration requirements. *Id.*

We submit that Judge Hamilton’s well-reasoned *Franklin/Templeton* decision dismissing – for a second time, and now with prejudice – a Section 47(b) claim brought by the same Plaintiff/counsel that is effectively indistinguishable from the Section 47(b) claim now before this Court in *Quest* provides yet another basis for this Court to dismiss that claim.

Dated: New York, New York
November 2, 2010

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***Attorneys for Defendants OppenheimerFunds
Distributor, Inc., William F. Glavin, and John V.
Murphy***

EXHIBIT A

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

BRADLEY C. SMITH,

Plaintiff,

No. C 09-4775 PJH

v.

**ORDER GRANTING MOTION
TO DISMISS**FRANKLIN/TEMPLETON
DISTRIBUTORS, INC., et al.,

Defendants.

Before the court is defendants' motion to dismiss the first amended complaint ("FAC") in the above-entitled action, for failure to state a claim. Having read the parties' papers and carefully considered their arguments and the relevant legal authority, and good cause appearing, the court hereby GRANTS the motion as follows.

This is a shareholder derivative suit, brought by plaintiff Bradley C. Smith, derivatively on behalf of nominal defendant Franklin Custodian Funds, a Delaware Statutory Trust ("the Trust"). Defendants are Franklin/Templeton Distributors, Inc. ("FTD") and ten members of the board of trustees of the Trust. Plaintiff filed the present action on October 6, 2009, alleging four causes of action – violation of § 47(b) of the Investment Company Act ("ICA"), 15 U.S.C. § 80a-46(b), against FTD; breach of contract, against FTD; breach of fiduciary duty against the trustee defendants; and waste of trust assets, against the trustee defendants.

The background of the case is as set forth in the June 8, 2010 order granting the defendants' motion to dismiss the original complaint. In that order, the court found that there was no private right of action under the sole federal claim – the claim under § 47(b) –

except to the extent that it provides a remedy for a violation of “any provision of [the ICA] or of any rule, regulation, or order thereunder.”¹ The court directed plaintiff that in order to state a claim under § 47(b), he must plead facts sufficient to show such a violation.

ICA § 47(b) provides, in relevant part:

(1) A contract that is made, or whose performance involves, a violation of this subchapter, or of any rule, regulation, or order thereunder, is unenforceable by either party . . . unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this subchapter.

(2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that the denial of rescission would produce a more equitable result than its grant

15 U.S.C. § 80a-46(b)(1), (2). The reference to “subchapter” throughout the statute is a reference to the ICA (15 U.S.C. §§ 80a-1 to 80a-64).

In the first cause of action in the FAC, plaintiff asserts a claim for “contract voiding” pursuant to ICA § 47(b). Plaintiff alleges that “due to the violation of core provisions of the ICA, Section 36(a) and Rule 38a-1, described herein, that require proper and lawful use of Trust assets, the Trust seeks to have its own contractual obligations deemed to be void by reason of Section 47(b), in an action maintained upon Section 47(b).” Plaintiff asserts that

¹ Plaintiff argues at some length that there is an implied independent private right of action under ICA § 47(b), based on the Supreme Court’s 1979 ruling in Transamerica Mortgage Advisors, Inc. v. Lewis (“TAMA”), 444 U.S. 11, 18 (1979), which construed § 215 of the Investment Advisers Act (“IAA”), 15 U.S.C. § 80b-15, to permit an action for rescission and restitution when a contract is contrary to a statute or regulation, while at the same time finding no implied right of action for damages under the predicate statute alleged to have been violated. This court previously considered this argument in connection with the motion to dismiss the original complaint, but concluded that the ruling regarding IAA § 215 has no applicability to the present case, in view of the fact that the statutory scheme at issue here is the ICA, and not the IAA, and the fact that no federal appellate court has ruled that there is a private right of action under ICA § 47(b) based on the reasoning in TAMA. Accordingly, the court did not find it necessary to address this question in the June 8, 2010 order.

Moreover, in August 2010, the Ninth Circuit considered whether there is a private right of action under ICA § 13(a), and found that apart from the limited provisions of the ICA that expressly provide for a private right of action, there is no evidence in the ICA’s statutory scheme that Congress intended to allow private enforcement of the ICA. See Northstar Fin. Advisors, Inc. v. Schwab Investments, 615 F.3d 1106, 1115-18 (9th Cir. 2010). The Ninth Circuit also noted that following the Supreme Court’s 2001 decision in Alexander v. Sandoval, 532 U.S. 275 (2001), “the modern trend has been for federal courts to deny the existence of implied private rights of action under the ICA.” Northstar, 615 F.3d at 1122.

1 the Trust “seeks a declaration that the contractual obligation to make payments of Trust
2 assets in the form of asset-based compensation to broker-dealers holding Trust shares in
3 brokerage account [sic] violates the Trustees’ duties under Section 36(a) of the ICA and
4 Rule 38a-1 to avoid improper use of Trust assets.” FAC ¶ 101.

5 Defendants argue that the § 47(b) claim must be dismissed for failure to state a
6 claim. A motion to dismiss under Rule 12(b)(6) tests for the legal sufficiency of the claims
7 alleged in the complaint. Ileto v. Glock, Inc., 349 F.3d 1191, 1199-1200 (9th Cir. 2003).
8 Review is limited to the contents of the complaint. Allarcom Pay Television, Ltd. v. Gen.
9 Instrument Corp., 69 F.3d 381, 385 (9th Cir. 1995). To survive a motion to dismiss for
10 failure to state a claim, a complaint generally must satisfy only the minimal notice pleading
11 requirements of Federal Rule of Civil Procedure 8. Rule 8(a)(2) requires only that the
12 complaint include a “short and plain statement of the claim showing that the pleader is
13 entitled to relief.” Fed. R. Civ. P. 8(a)(2). Specific facts are unnecessary – the statement
14 need only give the defendant “fair notice of the claim and the grounds upon which it rests.”
15 Erickson v. Pardus, 551 U.S. 89, 93 (citing Bell Atlantic Corp. v. Twombly, 550 U.S. 544,
16 555 (2007)).

17 All allegations of material fact are taken as true. Id. at 94. However, a plaintiff’s
18 obligation to provide the grounds of his entitlement to relief “requires more than labels and
19 conclusions, and a formulaic recitation of the elements of a cause of action will not do.”
20 Twombly, 550 U.S. at 555 (citations and quotations omitted). Rather, the allegations in the
21 complaint “must be enough to raise a right to relief above the speculative level.” Id. A
22 motion to dismiss should be granted if the complaint does not proffer enough facts to state
23 a claim for relief that is plausible on its face. See id. at 558-59. “[W]here the well-pleaded
24 facts do not permit the court to infer more than the mere possibility of misconduct, the
25 complaint has alleged-but it has not ‘show[n]’-that the pleader is entitled to relief.”
26 Ashcroft v. Iqbal, 556 U.S. ___, 129 S.Ct. 1937, 1950 (2009).

27 The court finds that defendants’ motion must be granted because the FAC fails to
28 allege facts sufficient to show a “predicate” violation of either ICA § 36(a) or SEC Rule

1 38a-1. ICA § 36(a) authorizes the SEC to bring a civil action alleging that a person acting
2 as an officer, director, member of an advisory board, investment advisor, or depositor, or
3 (with certain limitations) as a principal underwriter, has engaged or is about to engage "in
4 any act or practice constituting a breach of fiduciary duty involving personal misconduct in
5 respect of any registered investment company for which such person so serves or acts."
6 15 U.S.C. § 80a-35.

7 ICA § 36(a) does not provide either an express or an implied private right of action,
8 and does not, as plaintiff claims, either "create" a federal fiduciary duty or "regulate" the
9 "improper use of Trust assets." Nor does it provide a right of action for a claim for breach
10 of fiduciary duty or improper use of Trust assets. Rather, it simply authorizes the SEC to
11 file a civil action against certain "persons" for breach of fiduciary duty. Given that reading
12 of § 36(a), which appears clear to the court, it is difficult to see how defendants could be
13 said to have violated the statute. In any event, the FAC alleges no facts establishing any
14 such violation.

15 Similarly, as the court previously ruled in the June 8, 2010 order, Rule 38a-1 does
16 not provide either an express or implied private right of action. Rule 38a-1 simply requires
17 that every registered investment company adopt and implement written policies and
18 procedures designed to prevent violations of the federal securities laws, including policies
19 and procedures that provide for oversight of compliance by each investment advisor,
20 principal underwriter, administrator, and transfer agent of the fund; that it obtain the
21 approval of the board's board of directors of the adequacy of those policies and
22 procedures; that it annually review the adequacy of those policies and procedures; and that
23 it designate an individual responsible for administering the policies and procedures, who
24 will issue an annual written report on the operation of the policies and procedures and on
25 any "material compliance matter" that arises in the interim. See 17 C.F.R. § 270.38a-1.

26 Here, plaintiff has not plead facts sufficient to show any violation of Rule 38a-1.
27 Rule 38a-1 does not impose on funds a duty to assure that broker-dealers comply with
28 registration requirements, but rather simply requires funds to adopt and implement

1 compliance programs that are reasonably designed to prevent violation of the federal
2 securities laws. As was true with the original complaint, plaintiff has failed to allege facts
3 showing that the fund or funds at issue failed to adopt and implement compliance programs
4 that are reasonably designed to prevent violations of federal securities laws by the fund(s).

5 In accordance with the foregoing, the court finds that defendants' motion to dismiss
6 the first cause of action under ICA § 47(b) claim must be GRANTED. In view of plaintiff's
7 failure to cure the deficiencies of this claim through amendment, the dismissal is without
8 leave to amend. Further, as there is no federal claim remaining in the case, the court
9 declines to exercise supplemental jurisdiction over the remaining state law claims, pursuant
10 to 28 U.S.C. § 1367(c)(3). The second, third, and fourth causes of action are therefore
11 DISMISSED, without prejudice to refile in state court.

12 The date for the hearing on the motion, previously set for October 27, 2010, is
13 hereby VACATED.

14
15 **IT IS SO ORDERED.**

16 Dated: October 22, 2010



PHYLLIS J. HAMILTON
United States District Judge